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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965.

No. 362

ROBERT W. MATTHEWS, AS TRUSTEE IN BANKRUPTCY OF BEARD & COMPANY, INC.,

Petitioner,

vs.

JAMES TALCOTT, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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THE SUNTHORP-WARREN PRINTING COMPANY, CHICAGO

INDEX.

	PAGE
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement of the Case	3
Reasons for Granting the Writ	7
Conclusion	21
Appendix A—Opinions Below	23
Appendix B—Judgment Below	39
Appendix C—Statutes Involved	40

CITATIONS

Cases.

Bostian v. Park National Bank, 226 F. 2d 753 (8th Cir. 1955) 17

Byrne, In re, 32 F. 2d 189 (2nd Cir. 1925) 15

Cities Service Oil Co. v. Dunlap, 308 U. S. 208 (1939) .13, 15

Colbath v. Mechanicks National Bank, 96 N. H. 110, 70 A. 2d 608 (1950) 13, 14

Corn Exchange National Bank & Trust Co. v. Klauder, 318 U. S. 434 (1938) 10

Hatahley v. United States, 351 U. S. 173 (1956) 12

Lincoln National Bank & Trust Co. v. Nathan, 215 Ind. 178, 19 N. E. 2d 243 (1949) 20

McKenzie v. Irving Trust Co., 323 U. S. 365 (1945) ..7, 8, 10

Palmer v. Hoffman, 318 U. S. 109 (1943) 13, 16

Rosenbaum Grain Corp., In re, 112 F. 2d 315 (7th Cir. 1940) 15

Summit Hardware, Inc., In re, 302 F. 2d 397 (6th Cir. 1962), cert. dismissed sub nom. Foote v. Schwemler, 371 U. S. 881 (1962) 9, 13, 14

Union Trust Co. v. Wilson, 198 U. S. 530 (1905) 16, 17

United States v. United States Gypsum Co., 333 U. S. 364 (1948) 18, 19

Statutes.

Bankruptcy Act:

§ 1(30), 66 Stat. 420 (1952), 11 U. S. C. § 1(30) . 3, 11, 40

§ 60(a)(1), 64 Stat. 24 (1950), 11 U. S. C. § 96(a)(1) 3, 11, 40

§60a(2), 64 Stat. 24 (1950), 11 U. S. C. § 96(a)(2) 3, 8, 9, 11, 20, 40

§ 60b, 52 Stat. 869 (1938), 11 U. S. C. § 96(b) . . 3, 20, 41

Ind. Acts 1955, ch. 167 (Factor's Lien):

§ 1 ..... 3, 42

§ 2 ..... 3, 8, 9, 10, 13, 42

§ 3 ..... 3, 8, 43

§ 4 ..... 3, 44

§ 7 ..... 3, 44

Ind. Acts 1921, ch. 100 (Uniform Warehouse Receipts Act):

§ 22 ..... 3, 16, 45

§ 23 ..... 3, 45

Ind. Acts 1935, ch. 147 (Chattel Mortgage Act of 1935):

§ 2 ..... 3, 20, 45

§ 5 ..... 3, 20, 45

Ind. Acts 1923, ch. 3 (Burns' Ind. Stats. § 56-119) . . 3, 20, 46

New Hampshire R. C. L. 262-A, § 1 14

Uniform Commercial Code:
§ 7-207 17
§ 9-204(1) 11
§ 9-204(3) 10
§ 9-213(5) 11
§ 9-303 11

Miscellaneous.

4 Collier, Bankruptcy (14th Ed. 1959), par. 70.39[3] .. 15
H. R. Report No. 1293, Aug. 22, 1949, 81st Cong., 1st Sess., to accompany S. 88 10

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioner Robert W. Matthews, as Trustee in Bankruptcy of Beard & Company, Inc., prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above-entitled case on April 30, 1965.

OPINIONS BELOW.

There was no formal opinion of the District Court. The findings of fact and conclusions of law made by the District Court are contained in the record. (App. I, 254-266.)[1] The

1. "App. I", "App. II", and "App. III" refer to the appendix to appellant's brief, appendix to appellee's brief, and appellant's reply brief and appendix, respectively, as printed for the court of appeals. Besides the copies included in the certified record, petitioner has filed nine copies of each appendix with this Court. When a reference to one of the appendices is not given, the exhibits referred to in this petition are not contained in said appendices but are contained in the record certified to this Court as original papers.

opinions of the Court of Appeals are reported at 345 F. 2d 374, and are set out in Appendix A, *infra*.

JURISDICTION.

The judgment of the Court of Appeals was made and entered on April 30, 1965, and a copy thereof is set out in Appendix B, *infra*. Petitioner's timely petition for rehearing was denied on June 15, 1965. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

In a plenary action brought by a trustee in bankruptcy against a commercial finance company to recover certain proceeds from the sale of the bankrupt's property and the collection of accounts receivable on which the finance company claimed a lien by reason of a factor's lien agreement, warehouse receipts, assignments of accounts receivable and a chattel mortgage, the questions presented are:

1. Whether the four designations subjecting lumber inventory of the bankrupt to the factor's lien, made within four months prior to bankruptcy, constituted voidable preferences.

2. Whether any part of the bankrupt's inventory of wood mouldings was ever validly subjected to the factor's lien.

3. Whether non-negotiable warehouse receipts covering lumber inventory purportedly deposited in a field warehouse conducted on the bankrupt's premises vested title to such lumber in the holder of such receipts.

4. Whether certain assignments of accounts receivable, made by the bankrupt within ten days prior to bankruptcy, constituted voidable preferences.

5. Whether the bankrupt's leasehold improvements and certain other items of equipment not specifically listed in a chattel mortgage were subject to the lien of such chattel mortgage.

STATUTES INVOLVED.

The pertinent portions of Bankruptcy Act, § 1(30), 66 Stat. 420 (1952), 11 U. S. C. § 1(30); Bankruptcy Act, § 60a(1) and (2), 64 Stat. 24 (1950), 11 U. S. C. § 96(a)(1) and (2); Bankruptcy Act, § 60b, 52 Stat. 869 (1938), 11 U. S. C. § 96 (b); Ind. Acts 1955, ch. 167, §§ 1-4, 7, pp. 337-341; Ind. Acts 1921, ch. 100, §§ 22 and 23, p. 227; Ind. Acts 1935, ch. 147, §§ 2 and 5, pp. 501-2; and Burns' Ind. Stats. Ann. (1961 Repl.), § 56-119, Ind. Acts 1923, ch. 3, p. 18, are set forth in Appendix C, *infra*.

STATEMENT OF THE CASE.

Beard & Company, Inc., an Indiana corporation engaged in the manufacture and sale of wood mouldings and the wholesale distribution of lumber, was adjudicated a bankrupt on October 15, 1962, following the filing of a creditors' petition against it on September 28, 1962. The petitioner, Robert W. Matthews, is the duly elected, qualified and acting trustee in bankruptcy of the bankrupt. The respondent, James Talcott, Inc., is a New York corporation engaged in a general factoring and commercial finance business. (App. I, 254-255.)

On September 27, 1962, the respondent, claiming that it was a creditor of the bankrupt as of September 26, 1962, in the sum of $512,785.46, plus continuing interest and attorney's fees, and was secured by an assignment of accounts receivable, a factor's lien on inventory, warehouse receipts, and a chattel mortgage, purportedly took possession of all tangible personal property of the bankrupt located 1121 East 33rd Street, Indianapolis, Indiana, including all lum-

ber, mouldings, material and supplies, goods, wares and merchandise purportedly covered by the factor's lien agreement and the warehouse receipts, pursuant to a notice that was served on the attorney for the bankrupt. (Deft. Ex. 164.) Following the filing of the creditors' petition in involuntary bankruptcy, the petitioner was appointed receiver of the bankrupt on September 29, 1962, and took possession of the bankrupt's assets on October 1, 1962. (App. I, 174.)

Since it was desirable that the business of the bankrupt be continued on a basis that would permit an orderly liquidation of inventory and would give the petitioner an opportunity to sell certain assets on a going concern basis, the petitioner and respondent entered into a memorandum of agreement on October 15, 1962, approved by the bankruptcy court, that defined their respective rights. (App. III, 1-7.) Under the terms of said agreement, the petitioner disposed of all of the bankrupt's inventory of lumber and mouldings and other tangible personal property located at 1121 East 33rd Street, Indianapolis, Indiana, and turned the net proceeds over to the defendant. It was also agreed that accounts receivable of the bankrupt, which were in existence at the start of the bankruptcy and which had been assigned to the respondent, should be collected by the respondent, and that any checks in payment of said receivables received by the petitioner should be turned over to the respondent. It was further agreed that the petitioner had the right to contest the right of the respondent to retain said funds and to contest the validity of any alleged claims and security for claims in a plenary action brought for that purpose, that the rights of the parties should not be deemed altered except as specifically provided therein, and that the execution of the agreement by the petitioner should not be deemed an acknowledgment by the petitioner of the alleged liens or possession of the respondent.

Pursuant to said agreement the petitioner turned over to the respondent net proceeds from the sale of lumber and mouldings in the amount of $104,978.83, net proceeds from the sale of the machinery, equipment, supplies and leasehold improvements situated on the premises at 1121 East 33rd Street, Indianapolis, Indiana, in the amount of $11,235.44, and collections received by petitioner from accounts receivable in the amount of $72,207.07. (Ptf. Exs. E and I.) The petitioner disposed of all other assets of the bankrupt's estate, and as of the time of trial the balance in the petitioner's account as trustee of the bankrupt's estate was $14,795.62. The aggregate amount of claims filed against the bankrupt's estate, excluding the claim of respondent, total $453,955.98. (App. I, 174-175.) On the date of bankruptcy, most of the lumber and mouldings in the bankrupt's inventory, which respondent contended was covered by its factor's lien and warehouse receipts, had not been paid for. (App. I, 4.)

In accordance with the terms of the agreement (App. III, 4), petitioner instituted a plenary action in the United States District Court for the Southern District of Indiana to recover from the respondent a portion of the proceeds received from the sale of the bankrupt's property and the collection of its accounts receivable. Petitioner's complaint asserted (1) that the four designations of lumber inventory under the respondent's factor's lien, made within four months prior to bankruptcy, constituted voidable preferences; (2) that the bankrupt's inventory of wood mouldings had never been validly subjected to the respondent's factor's lien; (3) that the warehouse receipts held by the respondent were invalid and gave respondent no title to the lumber inventory purportedly evidenced thereby; (4) that certain assignments of accounts receivable made within ten days prior to bankruptcy constituted voidable preferences; and (5) that the bankrupt's leasehold im-

provements and certain other items of equipment were not subject to the lien of the respondent's chattel mortgage. The respondent filed an answer and the cause was tried to the court without the intervention of a jury. The evidence established that the proceeds attributable to the transaction challenged by petitioner amounted to $125,011.70.[2]

The district court made findings of fact and conclusions of law (App. I, 254-266) and entered a judgment for the respondent. (App. I, 266.) The district court held, *inter alia*, (1) that the designations subjecting lumber inventory to the factor's lien, made within four months prior to bankruptcy, related back to the date of filing of the notice of factor's lien; (2) that the letters purporting to subject the bankrupt's inventory of mouldings to the factor's lien were sufficiently complete so that any creditor, seeing the filed notice of factor's lien and making inquiry either of the bankrupt or respondent as to what merchandise was subject to the factor's lien, could have been fully advised; (3) that if any irregularities existed in connection with the operation of the field warehouse, respondent had no knowledge or notice thereof and its rights to the lumber covered by warehouse receipts was unimpaired; (4) that the assignments of accounts receivable made within the ten days immediately prior to bankruptcy represented proceeds of sale of merchandise covered by a valid factor's lien, and said accounts receivable were automatically subject to the factor's lien in favor of respondent; and (5) that the lien of respondent's chattel mortgage covered all tangible items of machinery, equipment, supplies and leasehold improvements under the blanket clause set forth therein.

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2. This figure has been computed from various exhibits contained in the record. The accuracy of the computation was not questioned by the respondent in the district court or in the court of appeals.

The petitioner appealed to the United States Court of Appeals for the Seventh Circuit from the judgment entered by the district court on May 25, 1964. (App. I, 267.) The court of appeals (Judge Schnackenberg dissenting) affirmed the judgment of the district court. (Appendix A, *infra.*)

REASONS FOR GRANTING THE WRIT.

Since the five questions presented for review are largely mutually exclusive, it is necessary, in setting forth the reasons relied on for the allowance of the writ, that each be separately considered.

I.

The decision below that the four designations subjecting lumber inventory of the bankrupt to the respondent's factor's lien, made within four months prior to September 28, 1962, the date of bankruptcy, related back to October 5, 1960, the date of filing of notice of the factor's lien, should be reviewed because it is in conflict with and misapplies the decision of this Court in *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365 (1945). In addition, by also basing its decision on the alternative ground that the four designations were supported by present consideration—a fact not found by the district court—the court of appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

A. In *McKenzie* v. *Irving Trust Co., supra,* the Court held that:

> "What constitutes a transfer and when it is complete within the meaning of § 60a of the Bankruptcy Act is necessarily a federal question, since it arises under a federal statute intended to have uniform application throughout the United States. * * * The statute provides its own definitions. * * *" (323 U. S. at 369-70.)

After quoting the definition of "transfer" in § 1(30) of the Bankruptcy Act and the provision of § 60a as to when a transfer shall be deemed to have been made, the Court continued:

> "In the absence of any controlling federal statute, a creditor or bona fide purchaser could acquire rights in the property transferred by the debtor, only by virtue of a state law. And hence § 60(a)'s 'apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good faith purchaser.' • • •" (323 U. S. at 370.)

The 1950 amendment to § 60a of the Bankruptcy Act discarded the "bona fide purchaser test" as to all transfers except those involving real property and substituted for it, as to all other transfers, a "lien creditor test." With this modification, the language of the Court in *McKenzie* is still applicable. Accordingly, what constitutes a transfer and when it is complete within the meaning of § 60a of the Bankruptcy Act is a federal question, and state law is looked to only for the purpose of determining when "a transfer of property other than real property • • • became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." Bankruptcy Act, § 60a(2).

Under the former Indiana factor's lien statute, Ind. Acts 1955, ch. 167, p. 337, under which the transactions involved in this case arose, four separate acts must have occurred before a factor could claim a lien against any specific property of the borrower. These are the following:

> 1. There must be a written agreement between the borrower and the factor providing for a continuing lien upon such merchandise of the borrower as is thereafter designated.

2. A notice of lien must then be filed in the office of the county recorder.

3. The particular merchandise to be covered by the lien must be designated in one or more separate written statements dated and signed by the borrower and delivered to the factor.

4. The factor must make loans to or for the account of the borrower.

In *In re Summit Hardware, Inc.*, 302 F. 2d 397 (6th Cir., 1962), cert. dismissed sub nom. *Foote* v. *Schwemler*, 371 U. S. 881 (1962), it was squarely held that a factor's lien is not created on specific merchandise until a designation is executed and delivered. The Ohio factor's lien statute involved in that case is the same in substance as the Indiana statute. It should be clear, therefore, that a lien on undesignated merchandise obtainable by legal or equitable proceedings on a simple contract would be superior to the rights of the factor.

In the case at bar, steps 1, 2 and 4, outlined above in the second preceding paragraph, occurred prior to four months before the date of bankruptcy. But by reason of § 60a(2) of the Bankruptcy Act, the designations made within four months prior to the date of bankruptcy constituted transfers by the bankrupt of the lumber covered thereby to the respondent on the dates thereof, since a simple contract creditor of the bankrupt levying execution on a judgment immediately prior to the execution and delivery of said designations could have obtained a lien on the lumber superior to the rights of the respondent.

Nevertheless, once a designation has been made, Sec. 2 of the Indiana factor's lien statute attempts to relate the effectiveness of the lien back to the date when notice of the factoring agreement was filed. One of the basic purposes of the bona fide purchaser test adopted by

the 1938 amendment of § 60a of the Bankruptcy Act was to prevent the validation of liens by relation back. See *Corn Exchange National Bank & Trust Co.* v. *Klauder,* 318 U. S. 434 (1943), at 438, footnote 11. In substituting the lien creditor test for the bona fide purchaser test, it was the purpose of the 1950 amendment of § 60a to retain unimpaired the basic object of the 1938 amendment, which was the elimination of the relation back and pocket lien doctrines. H. R. Report No. 1293, Aug. 22, 1949, 81st Cong., 1st Sess., to accompany S. 88. It is clear, therefore, that Sec. 2 of the Indiana factor's lien statute is ineffective as against a trustee in bankruptcy to relate the validity of the lien created by a designation back to the time of filing of the notice of factor's lien.

The district court squarely held that the designations made within four months of bankruptcy related back to the date of filing. (App. I, 265.) The court of appeals necessarily also so held since, as pointed out by Judge Schnackenberg in his dissent, "if the factor's lien did not relate back to October 5, 1960, then the factor's lien obtained by the designation dated September 27, 1962, was a voidable preference on the face of the [district] court's findings of fact." (Appendix A, *infra,* p. 38.) By approving the respondent's argument that the relation back provision of the Indiana factor's lien statute "must be given literal meaning in accordance with the holding in *McKenzie* v. *Irving Trust Co.,*" the court of appeals misapplied that decision and reached a result in conflict therewith.

The question of relation back of a factor's lien is of great importance to the administration of the Bankruptcy Act, since an analogous situation is presented by the Uniform Commercial Code. The U. C. C., § 9-204(3), provides that a security agreement may provide that collateral, whenever acquired, shall secure all obligations

covered by the security agreement. Section 9-204(1) provides that the security interest cannot attach until the debtor has rights in the collateral. Section 9-303 states that a security interest is not perfected until it has attached and other steps for perfection have been taken. Section 9-213(5) attempts to relate effectiveness of the security interest back to the date of the filing of the financing statement. Thus, under the U. C. C., it would appear that a transfer occurs whenever the security interest attaches to after-acquired property, which would be when the debtor obtains rights in that property. By the same token a transfer occurred under the Indiana factor's lien statute when a designation of property was executed and delivered. In view of §§ 1(30) and 60a of the Bankruptcy Act, it would be unreasonable to construe either a security interest under the U. C. C. or a factor's lien as attaching at any earlier date. The question of the relation back of security interests can thus be expected to recur frequently in the administration of the Bankruptcy Act.

B. As an alternative ground for its decision, the court of appeals held that the designations under the factor's lien, made within four months of bankruptcy, did not constitute preferences because they became security for advances made by the respondent against accounts receivable during the period under the cross-collateral clause contained in the factor's lien agreement. The court of appeals relied on a finding by the district court that the respondent made loans "down to and including September 26, 1962." (App. I, 264.) But the district court made no finding concerning the relation between the amount of the loans made during the four-month period and the amount of new collateral of all types received. The respondent's own loan records (Deft. Exs. 54, 147, 183 and Pltf. Ex. B) establish that between June 6, 1962, and September 27, 1962, the date of the last factor's lien designa-

tion, the respondent collected substantially more from assigned accounts receivable than it loaned to the bankrupt, and that, to replace the security of the accounts receivable collected during this period, the respondent received new assignments of accounts receivable in a face amount substantially in excess of loans made during the same period. The district court made no finding that the designations under the factor's lien, made within four months prior to bankruptcy, were supported by present consideration.

Where a district court fails to make findings on a material issue, the proper course for the appellate court is to reverse or vacate the decision and remand the case for findings by the district court. *Cf. Hatahley* v. *United States*, 351 U. S. 173, 182 (1956). It is clear that an appellate court should not make new independent findings of fact on a material issue. In holding that "the designations were not made for or on account of an antecedent debt as required by section 60 of the Bankrupcy Act, but constructively, at least, represented security for loans made during the critical four-month period," the court of appeals was making an independent finding of fact. The district court had made no such finding, and, moreover, such finding is without substantial evidence in the record to support it. In making an independent finding of fact as an alternative basis for its decision in this branch of the case, the court of appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

II.

The decision below that the respondent had a valid factor's lien on the bankrupt's inventory of wood mouldings should be reviewed because it decides an important state question in a way in conflict with the applicable Indiana law and is in conflict with the decision of the Sixth Circuit in *In re Summit Hardware, Inc.*, 302 F. 2d 397 (6th Cir. 1962), cert. dismissed sub nom. *Foote* v. *Schwemler*, 371 U.S. 881 (1962). In addition, the portion of the opinion that holds that the burden of proof is determined by the pleadings is in conflict with the decisions of this court in *Cities Service Oil Co.* v. *Dunlap*, 308 U.S. 208 (1939), and *Palmer* v. *Hoffman*, 318 U.S. 109 (1943).

A. The court of appeals, relying on the case of *Colbath* v. *Mechanicks National Bank*, 96 N.H. 110, 70 A. 2d 608 (1950), construed the Indiana factor's lien statute as not requiring new designations in order to subject replacement inventory to a factor's lien. (Appendix A, *infra*, p. 32.) Such holding is squarely in conflict with the express wording of the Indiana statute. Section 2 thereof is quite explicit that a factor's lien attaches only to "such merchandise of the borrower as is from time to time after the execution of said written agreement designated in one or more separate written statements dated and signed by the borrower and delivered to the factor." Moreover, the agreement between respondent and the bankrupt providing for the factor's lien contemplated that it would attach only to "goods and merchandise from time to time designated" by the bankrupt. (App. I, 21-22.) Consequently, the court of appeals was in error in stating that "the Indiana statute does not specify how frequently the designations must be made," for the statute clearly provides that a designation must be made as frequently as a lien is desired on specific merchandise. The court's reliance on *Colbath* was mis-

placed, because the New Hampshire law, R.C.L. 262-A, § 1, does not require designations of the merchandise subjected to the factor's lien. In this respect the New Hampshire factor's lien law is quite different from the Indiana law. The language quoted by the court of appeals from *Colbath* has reference to the written agreement between the factor and the borrower providing for the lien. Such written agreement is also required by the Indiana statute, but it is separate and distinct from the further requirements of designations.

The court of appeals also held (Appendix A, *infra*, p. 31) that

> "the written designations of wood mouldings, even though listed only in dollar amounts, were sufficiently complete so as to subject the bankrupt's stock of mouldings to the factor's lien. The fact that it would have been necessary to use parole evidence to identify the specific property secured by the lien does not affect the validity of the designations or of the lien."

The foregoing holding is in square conflict with the decision of the Sixth Circuit in *In re Summit Hardware, Inc., supra*, where in construing the identical provision of the Ohio factor's lien statute the court stated:

> "We think the purpose of requiring the dated and signed statements describing the merchandise was to provide written authentic records which third parties could examine and upon which they could rely, in order to ascertain just what property was included in the factor's lien. The records would serve to identify the property subject to the lien in the event of enforcement proceedings." (302 F. 2d at 401-2.)

B. No attempt was made by the bankrupt to subject to the respondent's factor's lien the replacements added to the mouldings inventory after July 31, 1962. (App. I, 43-48.)

In the district court the petitioner relied on the bankruptcy rule that the burden of proof was on the respondent, as a claimant to the assets in the hands of the trustee of a bankrupt's estate, to affirmatively establish what part of the mouldings inventory was subject to its factor's lien. *In re Rosenbaum Grain Corp.*, 112 F. 2d 315, 318 (7th Cir. 1940); *In re Byrne*, 32 F. 2d 189 (2nd Cir. 1925); 4 Collier, *Bankruptcy* (14th Ed. 1959), par. 70.39[3]. The agreement under which petitioner turned the net proceeds of the mouldings inventory over to respondent expressly provided that the rights of the parties should not be deemed altered and that the execution of the agreement should not be deemed an acknowledgment by the petitioner of the alleged liens or possession of the respondent. (App. III, 6-7.) Had this agreement not been executed, the respondent would have had to enforce its alleged factor's lien on the mouldings inventory in the bankruptcy court, and in such a proceeding it would have been required to identify positively the mouldings subject to its factor's lien. In view of the aforesaid non-waiver provisions of the agreement between petitioner and respondent, the execution and performance of such agreement did not cause such burden of proof to shift from the respondent to the petitioner.

Nevertheless, the court of appeals held (Appendix A, *infra*, p. 32) that:

> "The trustee brought the instant plenary action. Among his claims was the charge that the inventory of mouldings was never subjected to the factor's lien by proper written designations. Under this posture of the pleadings, it was the trustee who had the burden of proving this proposition rather than Talcott bearing the burden of disproving it."

The foregoing holding is in conflict with the decisions of this Court in *Cities Service Oil Co.* v. *Dunlap*, *supra*, and

Palmer v. *Hoffman, supra,* which both held that burden of proof is a matter of substance rather than procedure and does not depend upon the posture of the pleadings.

III.

The decision below that the non-negotiable field warehouse receipts held by the respondent were valid and gave respondent the right to the lumber covered thereby should be reviewed because it decides an important state question in conflict with the applicable Indiana law and is in conflict with the decision of this Court in *Union Trust Co.* v. *Wilson,* 198 U.S. 530 (1905).

The evidence was undisputed that the warehoused lumber was controlled by and records kept on the basis of lot numbers rather than by warehouse receipt numbers, and that lumber within the same lot for which separate warehouse receipts had been issued was not kept segregated. (App. I, 103-105.) Finding of fact 19 (App. I, 260) of the district court is consistent with this evidence. The court of appeals nevertheless stated (Appendix A, *infra,* p. 33) that:

> "We hold that these procedures constituted a sufficient segregation of the lumber so that the warehouse receipts were not invalid for any deficiency in this regard. Burns Ind. Stat. Ann. § 67-422 requires only such separation of the warehoused goods as will permit 'the identification and redelivery of the goods deposited.' The method of segregation employed here met this requirement."

But former Burns' § 67-422 (Ind. Acts 1921, ch. 100, § 22, p. 227), which was § 22 of the Uniform Warehouse Receipts Act, provided that:

> "a warehouseman shall keep the goods so far separate from the goods of other depositors, *and from other goods of the same depositor for which a separate re-*

> *ceipt has been issued,* as to permit at all times the identification and re-delivery of the goods deposited." (Emphasis supplied)

The requirement that the warehouseman keep separate the goods covered by each receipt is continued by the Uniform Commercial Code, § 7-207. It is clear, therefore, that the method of segregation employed here, i. e. by lot rather than receipt, did not meet this requirement of the Indiana law, and that the court of appeals decided the question in a way in conflict with the applicable state law.

The holding of the court of appeals that "the mere fact that the bankrupt itself had access to the stored goods did not impair the warehouse receipts lien" (Appendix A, *infra,* p. 34) is in conflict with the decision of this Court in *Union Trust Co.* v. *Wilson, supra,* where it was said:

> "When there is conscious control, the intent to exclude and the exclusion of others, with access to the place of custody as of right, these are all the elements of possession in the fullest sense. * * *
>
> "We deal only with the case before us. No doubt there are other cases in which the exclusive power of the so-called bailee gradually tapers away until we reach those in which the courts have held as matter of law that there was no adequate bailment. * * *" (198 U.S. at 537)

By the admission of the respondent's own witnesses (App. I, 67-68, 92-93, 249-250) there was a shortage in the amount of lumber subject to warehouse receipts in the amount of $28,000.00, for which the respondent asserted a claim against the warehouseman, and which the warehouseman settled and paid. This fact distinguishes the case of *Bostian* v. *Park National Bank,* 226 F. 2d 753 (8th Cir. 1955), relied on by the court of appeals, and causes the decision of the court of appeals to conflict squarely with *Union Trust Co.* v. *Wilson.*

IV.

The decision below that the finding of the district court that assignments of accounts receivable, made within ten days prior to bankruptcy, grew out of the sale of merchandise covered by the factor's lien was not clearly erroneous should be reviewed because it presents an important question in the administration of the Federal Rules of Civil Procedure and is in conflict with the decision of this court in *United States* v. *United States Gypsum Co.*, 333 U.S. 364 (1948).

The record clearly discloses that the bankrupt had accounts receivable that arose out of carload sales of lumber and osmose treatment of lumber owned by others. (App. II, income statement following p. 45.) Lumber sold by the carload was never subjected to the factor's lien, since such lumber never passed through the defendant's inventory. (App. I, 120.) Osmose treatment was a service that did not necessarily involve a sale of lumber by the bankrupt. (App. I, 197.) Moreover, the bankrupt had accounts receivable that arose from sales of lumber released or surreptitiously removed from the field warehouse. Consequently, it could not reasonably be inferred by the district court that all of the accounts receivable assigned on and after September 19, 1962 (Ptf. Exs. S to Z, incl.) arose out of the sale of inventory on which the defendant claimed a factor's lien.

The court of appeals nevertheless held that the finding of the district court (App. I, 265) was supported by testimony of an account executive of the respondent, that such evidence was undisputed, and that questions of credibility were properly resolved by the district court and are not to be considered on appeal. (Appendix A, *infra*, pp. 35-36.) But the testimony referred to by the court of appeals was contained in a deposition and consisted of answers to leading

questions posed by respondent's counsel. The testimony in question (App. I, 67) was as follows:

> "Q. But these accounts receivable grew automatically out of sales of merchandise?
>
> A. Yes.
>
> Q. And the merchandise was under your factor's lien at that time, is that correct?
>
> A. That is correct."

No question of credibility was resolved by the district court, because the foregoing testimony was by deposition. Moreover, the bald conclusion of respondent's account executive relied on by the court of appeals flies in the teeth of the established pattern of the bankrupt's business as shown by the bankrupt's financial statements and the other undisputed evidence mentioned in the second paragraph of this part IV. Thus, the decision of the court of appeals is in conflict with the decision of this Court in *United States* v. *United States Gypsum Co., supra,* where it was said:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.
>
> "* * * Where * * * testimony is in conflict with contemporaneous documents we can give it little weight, * * *." (333 U.S. at 395-6)

V.

The decision below that the bankrupt's leasehold improvements and certain other items of equipment not specifically described in the respondent's chattel mortgage were subject to the lien of such chattel mortgage should be reviewed because it decides an important state question in a way in conflict with the applicable Indiana law and presents an important question in the administration of the Bankruptcy Act.

The holding of the court of appeals that items not described in the respondent's chattel mortgage were covered under the blanket clause contained therein (Appendix A, *infra*, pp. 36-37) is squarely in conflict with the applicable provisions of the Chattel Mortgage Act of 1935. Section 2 thereof provides that a chattel mortgage "shall be a good and valid lien upon the property therein described", and section 5 provides that it "may validly include replacements of any of the mortgaged property therein described." A blanket clause is ineffective in view of said provisions.

In addition, the holding of the court of appeals that the bankrupt's leasehold improvements were validly subject to the respondent's chattel mortgage (Appendix A, *infra*, p. 37) is in conflict with the case of *Lincoln National Bank & Trust Co.* v. *Nathan*, 215 Ind. 178, 19 N. E. 2d 243 (1939). In the cited case, the Supreme Court of Indiana held that a valid lien on leasehold improvements can be acquired only by a duly recorded real estate mortgage. The opinion of the court of appeals ignores the provision of Burns' Ind. Stats. Ann., § 56-119, involved in *Nathan*, that provides that an unrecorded mortgage of an interest in lands "shall be fraudulent and void as against any subsequent purchaser, lessee or mortgagee in good faith and for a valuable consideration, having his deed, mortgage or lease first recorded." Since recording is required to perfect a mortgage of leasehold improvements, the respondent's mortgage, even if it had described the leasehold improvements, was not perfected within the purview of § 60a(2) of the Bankruptcy Act until the date of bankruptcy and is voidable by the petitioner under § 60b.

CONCLUSION.

Because of the variety of the issues involved in this case and their general importance in the administration of the Bankruptcy Act, review by this Court is merited. The present petition for a writ of certiorari should, therefore, be granted.

Respectfully submitted,

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APPENDIX A.

OPINIONS BELOW.

IN THE UNITED STATES COURT OF APPEALS.

For the Seventh Circuit.

SEPTEMBER TERM, 1964 — APRIL SESSION, 1965

No. 14745
ROBERT W. MATTHEWS, as Trustee in Bankruptcy of Beard & Company, Inc.,
Plaintiff-Appellant,
vs.
JAMES TALCOTT, INC.,
Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

April 30, 1965.

Before SCHNACKENBERG, KILEY, and SWYGERT, *Circuit Judges.*

SWYGERT, *Circuit Judge.* This is an appeal from a judgment in favor of defendant James Talcott, Inc. in a plenary action brought by the trustee in bankruptcy of Beard & Company, Inc., an Indiana corporation.

Beard & Company had conducted a lumber business in Indianapolis for a number of years before it was adjudi-

cated a bankrupt on October 15, 1962, following the filing of a creditors' petition in involuntary bankruptcy.

James Talcott, Inc., a New York corporation, with a principal office in Chicago, claimed rights as a secured creditor in all of the inventory, accounts receivable, and machinery and equipment. The inventory consisted of lumber and mouldings. Talcott had advanced money to Beard & Company, Inc., under a factor's lien agreement dated October 5, 1960, and on the security of warehouse receipts issued by a company known as Douglas-Guardian Warehouse Corporation. At the time of the bankruptcy, the total amount owed by Beard & Company to Talcott was $512,785.46.[1]

Talcott received word about September 25, 1962, that Board & Company had issued credit memoranda in the approximate sum of $200,000 against various accounts receivable. An investigation disclosed that certain of the accounts were fictitious. On September 27, 1962, Talcott took physical possession of all merchandise covered by its lien agreement. The following day the involuntary bankruptcy petition was filed.

Following the appointment of a trustee, the physical assets of the bankrupt were sold by the trustee with the approval of the district court. The net proceeds were turned over to Talcott under an agreement that if the trustee questioned the validity of the secured obligations claimed by Talcott, a plenary action might be filed. That is the genesis of the instant action.

Five issues were presented to the district court for

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1. This sum included loans against the following types of collateral:

Accounts Receivable	$338,659.12
Factor's Lien	54,500.00
Warehouse Receipts	55,626.34
Chattel Mortgage	14,000.00

decision: (1) whether designations of lumber inventory made within four months prior to bankruptcy were voidable preferences under section 60 of the Bankruptcy Act, 11 U. S. C. § 96; (2) whether the bankrupt's inventory of wood mouldings was subject to the factor's lien; (3) whether warehouse receipts held by Talcott covering lumber deposited in a field warehouse located on the bankrupt's premises were valid; (4) whether accounts receivable assigned by the bankrupt to Talcott within ten days of bankruptcy and growing out of sale of lumber covered by the factor's lien constituted voidable preferences; and (5) whether a chattel mortgage held by Talcott covered leasehold improvements and other items of equipment.

The district court entered findings of fact and conclusions of law, deciding in favor of Talcott on all issues. From the judgment this appeal was taken.

A general description of the arrangements by which Beard & Company secured financing from Talcott will now be stated. Additional details, however, will be considered when we treat the separate issues.

Prior to October, 1960, the bankrupt factored its accounts receivable with a lending company known as Walter E. Heller & Company. It also obtained inventory financing from that company on the security of warehouse receipts issued by Douglas-Guardian. In connection with the latter financing, the bankrupt sublet to Douglas-Guardian its entire lumber yard storage area on its premises.

On October 5, 1960, the bankrupt entered into a financing plan with Talcott to replace its arrangement with Heller & Company. The new arrangement contemplated financing by Talcott to the bankrupt secured by four types of security devices:

(1) The bankrupt agreed to assign to Talcott all of its accounts receivable then existing or thereafter created as

security for loans and advances made or to be made by Talcott for the account of the bankrupt. Talcott agreed that at the time of assignment of receivables it would advance to the bankrupt, at Talcott's discretion, a sum not exceeding eighty-five per cent of the net amount of receivables, less the agreed charge for interest. In practice, the bankrupt sent Talcott a daily schedule of assigned receivables listing the name and address of each account debtor, invoice date and number, and gross invoice amount.

(2) The bankrupt also agreed that for all of the advances made by Talcott the latter would have a continuing general lien upon all goods and merchandise from time to time designated, consigned to, or pledged with Talcott by the bankrupt, whether or not in Talcott's constructive, actual, or exclusive possession, and regardless of whether or not such goods and merchandise was in existence on October 5, 1960, or should come into existence subsequently thereto, or should subsequently thereto be acquired by the bankrupt, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such goods and merchandise. Notice of this lien was filed by Talcott on October 5, 1960, in the office of the Recorder of Marion County, Indiana, pursuant to the provisions of the Indiana Factor's Lien Act, Burns Ind. Stat. Ann. §§ 43-1201 to 43-1210. (1963 Supp.)[2] Commencing in October, 1960, the bankrupt periodically executed and delivered consecutively numbered written designations of lumber being subjected to this continuing general lien. The designations listed the total dollar amount of lumber covered thereby and had attached the invoices of the suppliers containing specific descriptions of the lumber. In practice, all purchases of lumber by the bankrupt not placed in the field warehouse were included in designations under the factor's

2. The act was repealed by Indiana Acts 1963, ch. 317, § 10-102.

lien. In addition, the bankrupt would usually write a monthly letter to Talcott setting forth the dollar amount of mouldings shown by the perpetual inventory records of the bankrupt but containing no specific description of the mouldings. Various amounts were loaned by the defendant to the bankrupt on the security of the inventory of lumber and mouldings covered by the factor's lien.

(3) The bankrupt also agreed that all loans and advances theretofore or thereafter made for its account and all other amounts owed by it to Talcott should be secured by a pledge to Talcott of goods and merchandise deposited in field warehouses acceptable to Talcott under agreements between the bankrupt and such warehouses pursuant to which negotiable or nonnegotiable warehouse receipts for such goods and merchandise should be issued. Pursuant to the agreement, Talcott approved the use of the field warehouse operated by Douglas-Guardian. The bankrupt purported from time to time to place lumber in this field warehouse, and Douglas-Guardian issued nonnegotiable warehouse receipts therefor in the name of Talcott. Talcott would lend the bankrupt amounts equal to 66⅔ per cent of the cost of the lumber evidenced by such receipts.

(4) On October 17, 1960, the bankrupt executed to Talcott a chattel mortgage on certain described machinery, equipment, office furniture, and fixtures owned by the bankrupt. The chattel mortgage secured a loan by Talcott to the bankrupt in the sum of $25,000, payable in twenty-two monthly installments of $500 each, commencing on November 15, 1960, and a final installment of $13,500 payable on October 15, 1962.

I.

Between October 13, 1960, and September 27, 1962, the bankrupt delivered to Talcott twenty-five separate designations of lumber inventory. Each described the lumber

thereby designated. Invoices directed to the bankrupt were attached. The trustee did not question the validity of the last four designations made within four months prior to bankruptcy, but attacked them as preferential and voidable. These designations, dated respectively June 6, 1962, July 24, 1962, August 28, 1962, and September 27, 1962, had an aggregate value of $193,751.03.

The district court ruled that the four designations, although made within the four-month period prior to bankruptcy, did not constitute preferences under section 60(a) of the Bankruptcy Act because "the designations of merchandise related back to October 5, 1960 when the Notice of Factor's Lien was filed by Talcott."

To determine when a transfer has been perfected under section 60(a), the law of the state where the transaction takes place must be consulted. *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365 (1945). The Indiana Factor's Lien Act gives a continuing lien upon the merchandise of the borrower as designated in separate written statements "dated and signed by the borrower and delivered to the factor." The act further provides that the lien shall cover "accounts receivable or other proceeds resulting from the sale or other disposition of any such merchandise."

The trustee contends that although the Indiana statute attempts to relate the effectiveness of the lien back to the date when notice of the factoring agreement was filed,[3] the lien does not attach to specific merchandise until such merchandise is designated. He further argues that a literal interpretation of sections 60 and 1(30) of the Bank-

3. Section 43-1202 Burns Ind. Stat. Ann. (1963 Supp.) reads in pertinent part:

> Such lien shall be valid from the time of filing the notice . . , whether such merchandise shall be in existence . . . at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower.

ruptcy Act, 11 U. S. C. §§ 96, 1(30), indicates that a separate transfer under these provisions occurs whenever a borrower acquires rights in new collateral since a creditor cannot acquire an interest in the goods before the borrower does.

Talcott, on the other hand, contends that the Indiana legislature anticipated the problem of an attempted avoidance by a trustee in bankruptcy of a factor's lien on inventory designated within four months prior to bankruptcy by specifically providing that the lien attachment to after-acquired property relates back to the time the notice was filed rather than to the time when the property was actually acquired by the borrower or designated by him under the lien agreement. Defendant concludes by arguing that the language of the Indiana statute must be given literal meaning in accordance with the holding in *McKenzie* v. *Irving Trust Co., supra.*

Even if we were to agree with the trustee that the challenged designations constituted transfers within the meaning of section 60(a), we would be constrained to hold that they were not voidable preferences. The district court found that Talcott had made loans to Beard & Company "down to and including September 26, 1962." We are satisfied that this finding is not erroneous. The record shows that from June 6, 1962, through September 26, 1962, Talcott advanced Beard & Company the sum of $591,264.63 on what was purported to be valid accounts receivable. Approximately $220,000 of these accounts were spurious, having been created through a system of duplicate invoicing of retail sales by the bankrupt. Thus, Talcott was induced to advance loans on security which was nonexistent except for the designations of lumber inventory which were made during the four-month period. The factor's lien agreement contained a cross-collateral clause whereby Talcott was given a continuing general lien on inventory, for

the "amount due upon any notes or other obligations given to or received by you [Talcott] for or upon account of any such loans or advances . . . no matter how or when arising and whether under the factoring agreement . . . or otherwise." Under this clause the designations in question became security for advancements secured by accounts receivable, purportedly valid but actually fictitious, in the approximate amount of $220,000. It is clear, therefore, that the designations were not made for or on account of an antecedent debt as required by section 60 of the Bankruptcy Act, but constructively, at least, represented security for loans made during the critical four-month period. Accordingly, the designations did not constitute preferences within the meaning of section 60 of the act.

II.

To designate raw materials, work in process, finished goods, and wood mouldings as security under the factor's lien agreement, the bankrupt on October 5, 1960, delivered a letter to Talcott designating by dollar amount its existing stock of wood mouldings subject to Talcott's factor's lien. Twenty-one similar letters were sent by the bankrupt to Talcott between October 31, 1960, and August 6, 1962. The last letter showed wood mouldings on hand on July 31, 1962, having a value of $126,297.18.

The district court found that the designations of wood mouldings of the bankrupt's inventory were sufficiently complete "so that any creditor seeing the recorded Notice of Factor's Lien and making inquiry either of Beard or Talcott as to what merchandise was subjected to said Factor's Lien, could have been fully advised." The district court also found that although a spot check of the perpetual inventory records made after bankruptcy "showed some discrepancies in actual physical count of the mer-

chandise, there was approximately as many overages as shortages." We conclude that these findings are not erroneous.

The periodic letters designated the bankrupt's entire stock of wood mouldings as subject to the factor's lien. The inventory was kept current by deducting sales and adding receipts. The balances shown by the inventory records would be priced out to obtain the dollar value of the mouldings; these amounts formed the bases of the designations. At any time, the dollar amounts could have been translated to specific mouldings subject to the factor's lien.

We are of the opinion that the written designations of wood mouldings, even though listed only in dollar amounts, were sufficiently complete so as to subject the bankrupt's stock of mouldings to the factor's lien. The fact that it would have been necessary to use parole evidence to identify the specific property secured by the lien did not affect the validity of the designations or of the lien. This proposition is in accord with Indiana law. In *Baldwin* v. *Boyce*, 152 Ind. 46, 51 N. E. 334 (1898), it was held with regard to a chattel mortgage that "a description of the property which will enable third persons, aided by the inquiries which the instrument itself indicates or suggests, to identify the mortgaged property is sufficient." In an earlier case, *Duke* v. *Strickland*, 43 Ind. 494 (1873), the Indiana supreme court said that, "It is well settled that parole evidence is admissible to show the identity of the property mortgaged."

The trustee points out that even if it were to be said that the letters were sufficiently complete so as to constitute adequate designations under the lien agreement, the last letter was dated July 31, 1962, and purported to cover wood mouldings on hand at that time. The trustee

contends that the inventory was reduced by sales occurring between July 31 and the date of bankruptcy and that no effort was made by the bankrupt to subject to the factor's lien the replacements added to the mouldings inventory after July 31. It is argued that Talcott had and failed to discharge the burden of establishing what part of the mouldings inventory on hand at the date of bankruptcy had been part of inventory on July 31, 1962, and what part had been acquired after that date.

The trustee brought the instant plenary action. Among his claims was the charge that the inventory of mouldings was never subjected to the factor's lien by proper written designations. Under this posture of the pleadings, it was the trustee who had the burden of proving this proposition rather than Talcott bearing the burden of disproving it.

We think there is an additional reason which defeats the trustee's position. The record indicates that it was the intention of Talcott and Beard & Company to subject to the factor's lien all the wood mouldings in inventory at any one time. The Notice of Lien referred to "wood mouldings." The Indiana statute does not specify how frequently the designations must be made. In these circumstances, we do not think that each time Beard & Company sold or added mouldings to its inventory that a new designation was necessary. Business realities would make such a requirement absurd. We are in agreement with what the New Hampshire supreme court said in dealing with a similar question under the Factor's Lien Law of that state: "It seems improbable that our Legislature intended that a general store borrower, for example, must separately consign each spool of thread, can of beans or package of gum to a lender bank in order to maintain the lien." *Colbath* v. *Mechanicks Nat'l Bank,* 96 N. H. 110, 70 A. 2d 608 (1950).

III.

As noted earlier, pursuant to an agreement between Beard & Company and Talcott, lumber was placed in a field warehouse operated on Beard's property by Douglas-Guardian. Defendant held nonnegotiable warehouse receipts on such lumber and claimed the proceeds from the sale of the warehoused lumber after bankruptcy. The trustee opposed the claim, contending that the warehouse receipts held by Talcott were merely "scraps of paper" giving Talcott no title to the lumber purportedly covered thereby. The trustee makes this contention on the grounds that there had never been a segregation of the warehoused lumber and that the warehouseman did not exercise proper possession and control over it.

Although the trustee complains of a failure to segregate the lumber covered by the warehouse receipts, there was evidence of the following. Lumber covered by these receipts was divided into lots, bundles, and tagged with stack cards placed on each bundle. When Talcott took over the warehouse receipt financing from Walter E. Heller & Company on October 5, 1960, a complete physical count of warehouse inventory was taken for Douglas-Guardian. As each succeeding bonded representative of Douglas-Guardian assumed his duties, a complete physical inventory of the warehouse lumber was taken and checked. Merchandise was released from the warehouse only upon the issuance of specific warehouse releases. We hold that these procedures constituted a sufficient segregation of the lumber so that the warehouse receipts were not invalid for any deficiency in this regard. Burns Ind. Stat. Ann. § 67-422 requires only such separation of the warehoused goods as will permit "the identification and redelivery of the goods deposited." The method of segregation employed here met this requirement.

The trustee advances several reasons for his claim that there was a failure by Douglas-Guardian to exercise proper possession and control over the warehoused lumber. First, he says that the individuals who acted as bonded representatives of the warehouse had been employed by the bankrupt and continued to render it services. It is argued that this situation created a conflict of interest which inevitably prevented these men from exercising impartial surveillance over the warehoused lumber. The trustee further questions the security of the warehouse procedures by pointing out that access to the lumber yard could be gained by going through the main office of the bankrupt, that the fence around the yard had long been in disrepair, and that the main gate to the yard could readily be opened. The district judge found, however, that the bonded representatives were "reliable men" and that although access to the yard could be gained through the office, no truck could enter or take delivery unless the gates were unlocked by one of them. The mere fact that the bankrupt itself had access to the stored goods did not impair the warehouse receipts lien. *Bostian* v. *Park Nat'l Bank,* 226 F. 2d 753 (8th Cir. 1955). The trustee argues that this rule is not applicable when there is evidence of fraud or surreptitious removal of the warehoused merchandise. Although there was some testimony that there was a shortage in the lumber, there was no finding of fraud or surreptitious removal.

After making extensive findings of fact, the judge concluded that "At all times from October 5, 1960, down to and including September 28, 1962, Douglas-Guardian had custody of an exercised dominion and control over the lumber inventory covered by warehouse receipts." Having reviewed the evidence, we hold that this finding was not erroneous and that there was sufficient evidence to warrant

the conclusion that the warehouse receipts were valid as issued to cover lumber properly subjected to the control of the field warehouseman.

IV.

Between September 19, 1962, and September 28, 1962, the bankrupt assigned to Talcott certain accounts receivable having an aggregate value of $29,783.65. During this same period, the bankrupt received an advance from Talcott on these accounts receivable in the amount of $1,300. Plaintiff contended that the difference between these two sums constituted a voidable preference and so sought return from Talcott of $28,483.65.

The Indiana Factor's Lien Act provides that when there is sale of merchandise subject to a lien, the lien attaches to the proceeds of the sale in the hands of the borrower. The district judge found that the assignments of accounts receivable here questioned by the trustee "grew out of the sale of merchandise covered by factor's lien, and the lien was transferred automatically to the proceeds of sale." In effect, the court found that the assignments of these accounts receivable constituted security in substitution of lumber covered by prior designations. The trustee contests this finding of fact as not supported by a "scintilla" of evidence. Nevertheless, there was testimony by the account executive of Talcott to the effect that these accounts receivable grew out of the sale of merchandise under the factor's lien. The trustee now attacks the credibility of the witness and thereby seeks to leave the district judge's finding of fact without support. The evidence offered in this regard was undisputed. Questions of credibility were properly resolved by the trial court and are

not to be considered on appeal. Accordingly, the district judge was correct in his determination that the assignments of accounts receivable were not voidable as preferential.

V.

As noted earlier, Talcott loaned Beard & Company $25,000 secured by a chattel mortgage. Among the physical assets sold by the trustee pursuant to orders of the bankruptcy court were certain items purportedly covered by the mortgage. The net proceeds from the sale of these items amounted to $2,488.35. This sum was turned over to Talcott. The trustee now seeks its return, claiming that the items sold were not covered by the mortgage.

The mortgage listed specific property identified as being located at the premises of the bankrupt. In addition to the specific listing of properties subject to the mortgage, the mortgage contained a blanket clause "including all small tools, dies, and all other goods and chattels of every description and kind." The instrument also covered "all stock, fixtures, tools, dies, jigs, goods, wares, merchandise and other chattels . . . now situated on the said premises or which may be hereafter acquired by and placed on the said premises by the mortgagor at any time hereafter, together with all other goods and chattels of the mortgagor."

The items the trustee now challenges as not specifically listed in the chattel mortgage were certain leasehold improvements, an automobile, a truck, an electric motor, an off-set press, a copying machine, and a radio music system. The district court, however, found that all of these items were covered by the blanket clause and concluded therefore that the proceeds from their sale belonged to Talcott. Although the more desirable procedure would be to

describe with greater specificity the property subject to a chattel mortgage, the blanket clause here covering all property at a specified location was sufficient to subject that property to the terms of the mortgage.

Plaintiff argues that the leasehold improvements were not properly the subject of the chattel mortgage but rather should have been covered by a real estate mortgage. The Indiana supreme court in *Lincoln Nat'l Bank & Trust Co.* v. *Nathan,* 215 Ind. 178, 19 N. E. 2d 243 (1939), held that property constituting an interest in real estate, even though possibly classed as personal, is properly mortgaged by a real estate mortgage. The court did not hold, however, that a chattel mortgage covering such an interest would not constitute a valid lien. Moreover, there has been no allegation made here that any mortgagee of the bankrupt's real estate was prejudiced by the inclusion in the chattel mortgage of the leasehold improvements thereon. In these circumstances, we hold that the district court was correct in its disposition of the proceeds from the sale of the leasehold improvements in the same fashion as its disposition of the other items covered in the blanket clause of the chattel mortgage.

The judgment is affirmed.

No. 14745

Circuit Judge SCHNACKENBERG, dissenting.

I find it necessary to dissent. The district court erred in holding that the designations under the factor's lien executed and delivered within four months of bankruptcy related back to October 5, 1960, the date the notice of factor's lien was filed. Under Burns' § 43-1202, a factor's lien does not attach to specific merchandise until such merchandise is designated in one or more written statements dated and signed by the borrower and delivered to the factor. Notwithstanding the further provision of said section that the lien thus acquired relates back to the date the notice of lien was filed, a transfer occurs under the provisions of §§ 60 and 1 (30) of the Bankruptcy Act each time such a designation is made, since the factor's lien does not become so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the right of the factor until the designation is made.

If the factor's lien did not relate back to October 5, 1960, then the factor's lien obtained by the designation dated September 27, 1962, was a voidable preference on the face of the court's findings of fact. All of the elements of a voidable preference were found by the court to exist on said date. Accordingly, the plaintiff, at the very least, was entitled to recover the proceeds of the lumber covered by this designation. With respect to the factor's lien obtained by the designations dated June 6, 1962, July 24, 1962, and August 28, 1962, the plaintiff clearly established all of the elements of a voidable preference, and the court's finding that the defendant had no reasonable cause to believe the bankrupt was insolvent on said dates is clearly erroneous.

APPENDIX B.

JUDGMENT BELOW.

UNITED STATES COURT OF APPEALS.

For the Seventh Circuit.

Chicago, Illinois 60610.

Friday, April 30, 1965.

Before

Hon. Elmer J. Schnackenberg, Circuit Judge,
Hon. Roger J. Kiley, Circuit Judge,
Hon. Luther M. Swygert, Circuit Judge.

Robert W. Matthews, as Trustee in Bankruptcy of Beard & Company, Inc., *Plaintiff-Appellant,* vs. James Talcott, Inc. *Defendant-Appellee.*	Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. 14745	

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, Indianapolis Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, Affirmed, with costs, in accordance with the opinion of this Court filed this day.

APPENDIX C.

STATUTES INVOLVED.

Bankruptcy Act, § 1(30), 66 Stat. 420 (1952), 11 U. S. C. § 1(30), reads as follows:

> " 'Transfer' shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor;"

Bankruptcy Act, § 60a (1) and (2), 64 Stat. 24 (1950), 11 U. S. C. § 96(a) (1) and (2), reads as follows:

> "a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.
>
> "(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract

could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition."

Bankruptcy Act, § 60b, 52 Stat. 869 (1938), 11 U. S. C. § 96(b), reads as follows:

"b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: *Provided, however,* That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

The pertinent parts of the factor's lien statute involved in this case, Ind. Acts 1955, ch. 167, §§ 1-4, 7, pp. 337-341, subsequently repealed upon the enactment of the Uniform Commercial Code, read as follows:

"SECTION 1. Wherever used in this act, the term 'merchandise' shall mean materials, goods in process, and finished goods intended for sale, whether or not requiring further manufacturing or processing, but shall not include machinery, equipment, or trade fixtures of the borrower; the term 'factor' and 'factors,' wherever so used, shall mean persons, firms, banks, and corporations, and their successors in interest, who advance money on the security of merchandise, whether or not they are employed to sell such merchandise; and the term 'borrower,' wherever so used, shall mean the owner of merchandise at wholesale, or his agent, who creates a lien in favor of a factor, but shall not include mercantile establishments selling at retail.

"SEC. 2. If so provided by any written agreement with the borrower, a factor shall have a continuing lien upon such merchandise of the borrower as is from time to time after the execution of said written agreement designated in one or more separate written statements dated and signed by the borrower and delivered to the factor, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of any such merchandise, without such merchandise being taken into the constructive or actual possession or custody of the factor or of a third person for the account of the factor, and such lien shall secure the factor for all his loans and advances to or for the account of the borrower, together with interest thereon, and also for the commissions, obligations, indebtedness, charges, and expenses properly chargeable against or due from said borrower, and for the amounts due or owing upon any notes or other obligations given to or received by the factor for or upon account of any such loans or advances, interest, commissions, obligations, indebtedness, charges,

and expenses. Such lien shall be valid from the time of filing the notice hereinafter referred to, whether such merchandise shall be in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice or shall come into existence subsequently thereto and shall subsequently thereto be acquired by the borrower: Provided, That a notice of the lien is filed stating:

(a) The name of the factor; the name under which the factor does business, if an assumed name, the principal place of business of the factor within the state, or, if he has no place of business within the state, his principal place of business outside the state; and, if the factor is a partnership or association, the names of the partners, and if a corporation, the state under whose laws it was organized.

(b) The name and address of the borrower; the name under which the borrower does business, if an assumed name; the principal place of business of the borrower within the state, or, if he has no place of business within the state, the principal place or places at which the merchandise shall be located or stored; and the interest of the borrower in the merchandise and/or accounts receivable as far as known to the factor.

(c) The general character of merchandise and/or accounts receivable subject to the lien, or which may become subject thereto, and the period of time during which such loans or advances may be made under the terms of the written agreement providing for such loans or advances and for such lien.

"SEC. 3. Such notice of lien shall be verified by the factor to the effect that the statements therein contained are true to the best of the factor's knowledge. It must be filed in the office of the county recorder in the county where the merchandise subject to the lien is located, kept, or stored. Such recorder shall cause each notice of lien filed to be marked with a consecutive file number and with the date and hour

of filing, to be kept in a separate file, and to be noted and indexed in a suitable index, arranged according to the name of the borrower and containing a notation of the factor's chief place of business as given in the notice of lien. Amendments of the notice may be filed from time to time in the same manner to record any changes in the information contained in the original, subsequent, or amended notices. Such recorder, at the time of filing such notice, or amended notice or notices, shall upon request issue to the person filing the same a receipt in writing setting forth the filing data. No mistake or omissions of any recorder shall impair the lien.

"SEC. 4. Such notice may be filed at any time after the making of the agreement and shall be effectual from the time of filing as against all claims of unsecured creditors of the borrower and as against subsequent liens of creditors, except any common-law or statutory liens of processors, mechanics, artisans, or others subsequently attaching to such merchandise by reason of work or services rendered thereon, whether or not filing has occurred as prescribed by this act; but this act shall not obligate the factor personally for any debt secured by such lien. When merchandise subject to the lien provided for by this act is sold in the ordinary course of the business of the borrower, such lien, whether or not the purchaser has knowledge of the existence thereof, shall terminate as to the merchandise so sold and shall attach without further act, writing or formality to any obligation and to any other proceeds of such sale in the hands of the borrower."

* * * * *

"SEC. 7. The lien of the factor upon any accounts receivable resulting from the sale or other disposition of the merchandise subject to the lien provided for herein, shall be governed as far as applicable by the provisions of Chapter 107 of the Acts of 1945 and amendments thereto: Provided, however, That unless the factor and the borrower shall agree otherwise, the delivery by the borrower to the factor of a written

agreement or separate written statement as hereinbefore provided for designating the merchandise which will be subject to the lien, shall operate as an assignment of the accounts receivable which will result from the sale or other disposition of such merchandise with the same effect as if an assignment thereof by the borrower to the factor had been duly perfected under said Chapter 107 immediately after such sale or other disposition."

The pertinent parts of the Uniform Warehouse Receipts Act involved in this case, Ind. Acts 1921, ch. 100, §§ 22 and 23, p. 227, subsequently repealed upon the enactment of the Uniform Commercial Code, read as follows:

"SEC. 22. Except as provided in the following section, a warehouse man shall keep the goods so far separate from goods of other depositors, and from other goods of the same depositor for which a separate receipt has been issued, as to permit at all times the identification and re-delivery of the goods deposited.

"SEC. 23. If authorized by agreement or by custom, a warehouseman may mingle fungible goods with other goods of the same kind and grade. In such case the various depositors of the mingled goods shall own the entire mass in common and each depositor shall be entitled to such portion thereof as the amount deposited by him bears to the whole."

The pertinent parts of the Chattel Mortgage Act of 1935, involved in this case, Ind. Acts 1935, ch. 147, §§ 2 and 5, pp. 501-2, subsequently repealed upon the enactment of the Uniform Commercial Code, read as follows:

"SEC. 2. * * * Such mortgage shall be a good and valid lien upon the property therein described and thereby conveyed, * * *.

* * * * *

"SEC. 5. Any mortgage executed under and pursuant to this act may validly include replacements of any of the mortgaged property therein described * * *."

The statute governing the recording of mortgages of interests in real estate situated in Indiana, Burns' Ind. Stats. Ann. (1961 Repl.), § 56-119, Ind. Acts 1923, ch. 3, p. 18, reads as follows:

> "SEC. 16. Every conveyance or mortgage of lands or of any interest therein, and every lease for more than three years shall be recorded in the recorder's office of the county where such lands shall be situated; and every conveyance, mortgage or lease shall take priority according to the time of the filing thereof, and such conveyance, mortgage or lease shall be fraudulent and void as against any subsequent purchaser, lessee or mortgagee in good faith and for a valuable consideration, having his deed, mortgage or lease first recorded."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

NO. 362

ROBERT W. MATTHEWS, as Trustee in Bankruptcy of BEARD & COMPANY, INC.,
Petitioner,

v.

JAMES TALCOTT, INC.,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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INDEX

	Page
OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
STATUTES INVOLVED	3
STATEMENT OF THE CASE	4
ARGUMENT	11
1. The Respondent's Factor's Lien on the Lumber Inventory	12
2. The Designations of Wood Mouldings	20
3. Warehouse Receipts	24
4. Assignment of Accounts Receivable	25
5. The Chattel Mortgage	26
CONCLUSION	26

LIST OF AUTHORITIES

Cases

Page

District of Columbia v. Sweeney, 310 U. S. 631, 84 L. Ed. 1402, 60 S. Ct. 1082 (1940) 20

Graver Tank and Manufacturing Co. v. Linde Air Products Company, 336 U. S. 271, 93 L. Ed. 672, 69 S. Ct. 535 (1949) 14

In Re Summit Hardware, Inc., 302 F. 2d 397 (6th Cir., 1962), cert. dismissed sub nom. Foote v. Schwemler, 371 U. S. 882, 9 L. Ed. 2d 118, 83 S. Ct. 154 (1962) ..18, 21

Mattes v. American Acceptance Corporation, 204 F. Supp. 26 (M. D. Pa. 1961) *aff'd.* 301 F. 2d 908 (3d Cir., 1962) 16, 17

McKenzie v. Irving Trust Company, 323 U. S. 365, 89 L. Ed. 305, 65 S. Ct. 405 (1945) 14, 15

Ruhlin v. New York Life Insurance Company, 304 U. S. 202, 82 L. Ed. 1290, 58 S. Ct. 860 (1937) 21

Union Trust Company v. Wilson, 198 U. S. 530, 49 L. Ed. 1154, 25 S. Ct. 766 (1905) 25

United States v. Denver & R.G.R. Company, 191 U. S. 84, 48 L. Ed. 106, 24 S. Ct. 33 (1903) 23

United States v. Durham Lumber Company, 363 U. S. 522, 4 L. Ed. 2d 1371, 80 S. Ct. 1282 (1960) 19

United States v. Johnston, 268 U. S. 220, 69 L. Ed. 925, 45 S. Ct. 496 (1924) 26

LIST OF AUTHORITIES—Continued

Statutes

Page

Bankruptcy Act:

Sec. 60a(1) and (2), 64 Stat. 24 (1950), 11 U.S.C. Sec. 96a(1) and (2) 3

Sec. 60b, 52 Stat. 869 (1938), 11 U.S.C. Sec. 96b 3

Ind. Acts 1955, ch. 167, Sec. 1-4, Sec. 7, pp. 337-341; Burns' Indiana Statutes (1963 Supp.), Sec. 43-1201 to 43-1204, 43-1207; (Repealed by the Uniform Commercial Code, July 1, 1964, Indiana Acts 1963, Ch. 317, Sec. 10-102) 3, 5, 14

Court Rules

Rules of the Supreme Court of the United States, Rule 19 2

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Opinions Below

Although there was no formal opinion of the District Court, the Judgment Entry is set forth in the Appendix to Appellant's Brief before the United States Court of Appeals, at page 266. The District Court found for the Respondent, James Talcott, Inc., on all issues. The Judgment Entry was supported by detailed Findings of Fact and Conclusions of Law, set forth at pages 254 to 266 of that Appendix.[1]

[1] For convenience, we also will use "App. I" to refer to the Appendix to Appellant's Brief in the Court of Appeals, "App. II" to refer to the Appendix to Appellee's Brief, and "App. III" to refer to the Appendix to Appellant's Reply Brief.

The opinion of the United States Court of Appeals for the Seventh Circuit is reported in 345 F. 2d 374 (1965). It affirmed the ruling of the District Court.

Jurisdiction

The Petitioner is invoking the jurisdiction of this Court under 28 U.S.C., Sec. 1254(1). As set forth in Rule 19 of the Supreme Court of the United States, "a review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor."

Questions Presented

The questions presented for review involve an interpretation of the Factor's Lien Law of the State of Indiana, and a consideration of factual questions that were decided in favor of the Respondent in the trial court. The questions include the following:

1. Did the Court of Appeals err in affirming the District Court in its Findings and Conclusions that four designations of lumber inventory, subjecting lumber of the bankrupt to the Respondent's factor's lien, made within four months prior to bankruptcy, did not constitute voidable preferences?

2. Did the Court of Appeals err in affirming the District Court in its Findings and Conclusions that letters designating the inventory of wood mouldings, by general description and dollar amounts, were valid and sufficient to subject the bankrupt's inventory of wood mouldings to Respondent's factor's lien?

3. Did the Court of Appeals err in affirming the District Court in its Findings and Conclusions that warehouse

receipts held by the Respondent, covering lumber inventory of the bankrupt deposited in a field warehouse conducted on the bankrupt's premises by an independent warehouse company, gave the Respondent a valid security interest in such lumber?

4. Did the Court of Appeals err in affirming the District Court in its Findings and Conclusions that accounts receivable assigned by the bankrupt to Respondent within ten days prior to bankruptcy grew out of the sale of merchandise covered by Respondent's factor's lien, and the lien was transferred automatically to the proceeds of sale?

5. Did the Court of Appeals err in affirming the District Court in its Findings and Conclusions that the lien of the chattel mortgage held by Respondent covered all tangible items of machinery, equipment, supplies and leasehold improvements of the bankrupt, under the blanket clauses set forth therein?

Statutes Involved

The pertinent provisions of the Bankruptcy Act are Sections 60a(1) and (2) and 60b. 64 Stat. 24 (1950), 11 U.S.C., Sec. 96a(1) and (2); and 52 Stat. 869 (1938), 11 U.S.C., Sec. 96b.

The pertinent provisions of the Indiana Factor's Lien Law are set forth in Indiana Acts 1955, Ch. 167, Sec. 1-4, Sec. 7, pp. 337-341; Burns' Indiana Statutes (1963 Supp.), Sec. 43-1201 to 43-1204, 43-1207. This Act was repealed by Indiana Acts 1963, Ch. 317, Sec. 10-102, adopting the Uniform Commercial Code, which became effective in Indiana on July 1, 1964.

The statutory provisions are set forth at pages 40 to 46 of Petition in Appendix C.

Statement of the Case

The Petition seeks this Court's review of a judgment of the United States Court of Appeals for the Seventh Circuit affirming a judgment of the United States District Court for the Southern District of Indiana, Indianapolis Division, in favor of the Respondent, James Talcott, Inc. The issues arose in a plenary action to set aside alleged voidable preferences, under Sec. 60 of the Bankruptcy Act.

A Creditor's Petition in Involuntary Bankruptcy was filed against Beard & Company, Inc., on September 28, 1962. Adjudication followed on October 15, 1962. Robert W. Matthews was appointed Receiver and subsequently became Trustee. The Bankrupt had been engaged in the manufacture and sale of wood mouldings and the wholesale distribution of lumber.

On October 5, 1960, the Bankrupt had entered into a factoring agreement with the Respondent. From that date until September 26, 1962, the Respondent continuously loaned money to the bankrupt, always on a secured basis. The primary instrument of the transaction provided for an assignment of all of the accounts receivable of the bankrupt to Respondent. In return, Respondent agreed to advance a sum up to 85% of the net amount of the receivables. (App. I, 13).

The first supplement gave Respondent a factor's lien on:

> "all goods and merchandise from time to time designated, consigned to or pledged with you by the undersigned (Beard & Company, Inc.) whether in your constructive, actual or exclusive occupancy or possession or not, and whether or not such goods and merchandise shall be in existence at the date hereof or shall come into existence subsequently thereto, or

shall subsequently thereto be acquired by the undersigned, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of such goods and merchandise." (App. I, 21).

Notice of this lien was filed by Respondent on October 5, 1960, in the office of the Recorder of Marion County, Indiana, pursuant to the provisions of the Indiana Factor's Lien Act, Indiana Acts 1955, Ch. 167; Burns' Indiana Statutes (1963 Supp.), Sec. 43-1202.

The second supplement provided that the Defendant would also be secured by a pledge of goods and mechandise deposited in a field warehouse, under an agreement between the Bankrupt and a professional warehouseman, pursuant to which non-negotiable warehouse receipts for such goods and merchandise were to be issued by the warehouseman to the Defendant. (App. I, 25).

The Respondent advanced specific sums to the bankrupt on the security of warehouse receipts. It also made a chattel mortgage loan on machinery, equipment, fixtures and other personal property of the bankrupt. All security agreements were in writing, and all instruments were properly filed and recorded in accordance with the requirements of Indiana law (Findings of Fact, 9, 31; App. I, 256, 263).

By mid-September, 1962, the bankrupt had outstanding loans from the Respondent in excess of $500,000.00. The Respondent received word, on September 25, 1962, that the bankrupt had issued credit memoranda in the approximate sum of $200,000.00 against various assigned accounts receivable (App. I, 64). An immediate investigation disclosed that certain of the assigned accounts had been fictitious. Pursuant to the provisions of the security agreement, the Respondent took physical possession of all merchandise

covered by its factor's lien agreement on September 27, 1962. The bankruptcy proceedings then ensued on September 28. At the time of the bankruptcy, the bankrupt owed the Respondent $512,785.46. (App. I, 34).

By agreement between the Receiver and the Respondent, approved by the District Court, the physical assets were sold by the Receiver and Trustee. The net proceeds were turned over to the Respondent under an agreement that if the Trustee questioned the validity of the secured obligations claimed by Respondent, a plenary action could be filed in the United States District Court for the Southern District of Indiana.

Such an action was filed by the Trustee. It raised five (5) separate issues:

1. It alleged a preference in favor of the Respondent arising from four (4) designations of lumber inventory under the Factor's Lien Law of the State of Indiana, within the four (4) months prior to bankruptcy. Of the $25,607.70 realized from the liquidation of such lumber in the bankruptcy proceedings, the sum of $14,688.57 represented the net proceeds from the sale of lumber which had been subjected to the factor's lien by designations executed within four (4) months of the date of bankruptcy. The Trustee sought to recover this sum as a voidable preference. The Respondent admitted that the four (4) designations subjecting lumber inventory to the factor's lien were made during the four (4) months prior to bankruptcy. But, Respondent alleged that the designations of lumber inventory were made pursuant to the Factor's Lien Law of the State of Indiana, and that the lien in each instance related back to October 5, 1960, the date on which the notice of factor's lien was filed in accordance with the Indiana statute.

In addition, it was alleged (and the District Court held) that the Respondent had no reasonable cause to believe that the bankrupt was insolvent at any time prior to September 25, 1962 (App. I, 264). This in itself ruled out any possible voidable preference on the first three questioned designations of lumber inventory made in June, July and August, 1962. The Court of Appeals did not disturb this finding of the District Court. Thus, the only designation of lumber inventory after Respondent had reasonable cause to believe that Beard & Company, Inc. was insolvent, occurred on September 27, 1962. The proceeds of factor's lien lumber allocable to that designation were in the sum of $4,278.03.[2]

Finally, Respondent alleged (and the District Court and the Court of Appeals held) that Respondent made loans to the bankrupt from June 6, 1962, through September 26, 1962 (App. I, 264) representing money advanced in the sum of $591,264.63 (App. II, 43-45). The factor's lien was to provide for security for all moneys loaned, under its cross-

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[2] Plaintiff's Exhibits NN and OO, filed as part of the Record in this cause, give a detailed analysis of lumber inventory. Exhibit NN shows what portions of the lumber physically on hand at the start of bankruptcy were covered by warehouse receipts, and what portions were attributable to the factor's lien. Exhibit OO shows what portions of the lumber covered by the factor's lien were attributable to each specific designation of inventory.

Plaintiff's Exhibit R, filed as part of the Record, was an appraisal of lumber and mouldings. It showed certain proportional values which were applied in Plaintiff's Exhibit TT, set forth in App. I at page 226. These methods of allocation led Petitioner to contend, at page 27 of his Brief before the Court of Appeals, that the moneys turned over to Talcott from the proceeds of factor's lien inventory should be attributed to the following designations:

September 27, 1962	$ 4,278.03
August 28, 1962	$ 8,506.55
July 24, 1962	$ 1,219.24
June 6, 1962	$ 664.75
Designations prior thereto	$10,939.13

collateral provisions (App. I, 21). Therefore, the designations of lumber inventory were part of the security for current advances, and were not transfers on account of an antecedent debt as required by Sec. 60 of the Bankruptcy Act to make the transactions preferential. This gives further force to Finding 36 of the trial court that:

> "While Beard may have been insolvent on the dates of said respective designations, no voidable preference took place." (App. I, 264)

2. The second issue involved the validity of Respondent's factor's lien on the bankrupt's wood mouldings inventory. The Trustee questioned the factor's lien on those items because the designations of mouldings inventory were made by dollar amounts rather than by specifically itemizing the mouldings covered. The bankrupt sent to Respondent, approximately at monthly intervals beginning on October 5, 1960, and continuing to August 6, 1962, twenty-two (22) written designations and schedules of merchandise subject to Respondent's continuing general lien. The written designations referred to "raw materials and work in process, consisting of lumber of varying grades and sizes and wood mouldings" and "finished goods, consisting of wood mouldings" and gave a dollar amount for each category of inventory.

The inventory of mouldings designated in the schedules was physically present at the plant of the Bankrupt in Indianapolis at all of the dates indicated (App. II, 36-37, 40-42). Both the District Court and the Court of Appeals held that under Indiana law, the dollar amount designations and the recorded notice of factor's lien were adequate to subject the wood mouldings of the Bankrupt to the Respondent's factor's lien.

3. The third issue involved the validity of warehouse receipts held by Respondent. These covered lumber inventory of the Bankrupt deposited in a field warehouse conducted on the Bankrupt's premises by Douglas Guardian Warehouse Corporation. There is extensive evidence of the mechanics of the operation of the warehouse. This issue was purely factual and both the District Court and the Court of Appeals held that Douglas Guardian had custody of, and exercised dominion and control over, the lumber inventory covered by the warehouse receipts held by Respondent. This was sufficient to create completely valid warehouse receipts and to protect the lien of the Respondent on the lumber covered by the receipts.

4. The fourth issue involved the validity of the assignments of accounts receivable by the Bankrupt to Respondent during the period between September 19, 1962, and September 28, 1962, the date of bankruptcy. This, too, was a fact question. The facts showed that the accounts receivable assigned during this period grew out of the sale of merchandise covered by Respondent's factor's lien (App. I, 67). Therefore, as Respondent argued (and as the District Court and the Court of Appeals held) under Indiana law, the designation of merchandise subject to a factor's lien, operates automatically as an assignment of the accounts receivable resulting from the sale of such merchandise.

In addition, new money was being advanced to the Bankrupt by Respondent during the time the accounts receivable were assigned. Also, the accounts receivable assigned prior to September 25, 1962, could not be regarded as voidable preferences because there was no showing that Respondent had any reasonable cause to believe that the Bankrupt was insolvent prior to that time.

5. The last issue involved a dispute over whether certain personal property of the Bankrupt not specifically listed in the Respondent's chattel mortgage was subject to the lien of that chattel mortage. The mortgage contained a list of specific machinery and equipment which was identified in the mortgage as being located at 1121 East 33rd Street, Indianapolis, Indiana. The mortgage also contained certain blanket clauses indicating that it covered additional personal property of the Bankrupt which was not specifically described. The District Court and the Court of Appeals held that, under Indiana law, the lien of the chattel mortgage covered all tangible items of machinery, equipment, supplies and leasehold improvements under the blanket clauses set forth therein. The recording of the mortgage was sufficient notice to enable any creditor, by inquiry suggested in the instrument itself, to identify all of the property covered thereunder.

ARGUMENT

Although this case involves five (5) separate questions, the legal issues are extremely narrow and do not warrant review by this Court on certiorari. The decision of the Court below hinges primarily on the approval of the findings of fact by the District Court, and the determination that the Respondent took all steps required by Indiana law to perfect and protect the lien of its various security devices. The conflicts between the decision of the Court below and the decisions of this Court, which are alleged by the Trustee as the basis for his Petition, simply do not exist.

There is no conflict between the decision of the Court below and the decision of another Court of Appeals on the same matter. There is no conflict between the decision of the Court below and applicable state law in the State of Indiana. There is no basis whatever for Petitioner's allegation that the Court below has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

The findings of fact and conclusions of law of the District Court are amply documented. The District Judge interpreted the Indiana Factor's Lien Law, not previously considered by any Appellate Court of the state, as meaning exactly what it says—that the lien is valid from the time of filing the original notice with the County Recorder, if the statutory requirements are met. The Court of Appeals has affirmed the ruling of the District Court that no voidable preferences resulted.

Moreover, with the undisturbed finding of the District Court that the Respondent had no reasonable cause to believe that Beard was insolvent at any time prior to September 25, 1962 (App. I, p. 264), the dollar amount attributable to the final designation of inventory is relatively small.

The reasons relied on for the allowance of the writ will be met here in the same order they are presented in the Trustee's Petition, pp. 7-20.

1. The Respondent's Factor's Lien on the Lumber Inventory.

On October 5, 1960, Beard & Company, Inc. entered into a written factoring agreement with the Respondent. On that same day, pursuant to Indiana law, notice of this arrangement was filed with the Recorder of Marion County, Indiana. The notice identified the general character of merchandise and accounts receivable subject to the lien or which might become subject to the lien as follows:

> "All raw materials, including, but not by way of limitation, lumber of varying sizes and grades; all work in process and all finished goods, including, but not by way of limitation, wood mouldings, together with all accounts receivable resulting from the sale of the foregoing finished products and goods."

Between October 13, 1960, and September 27, 1962, the Bankrupt delivered to the Respondent twenty-five (25) separate designations of lumber inventory. Each described the lumber thereby designated. The Trustee attacked the last four (4) designations made within four (4) months prior to bankruptcy as voidable preferences. The District Court and the Court of Appeals denied this contention.

A. The Decision of the Court Below is Clearly Correct.

The Court below, after carefully reviewing the extensive findings of fact of the Trial Court, correctly held that the four (4) questioned designations were not made for or on account of an antecedent debt as required by Sec. 60 of the Bankruptcy Act. The four (4) questioned designations were security for loans made within the four-month period prior to bankruptcy.

From June 6, 1962, through September 26, 1962, the Respondent advanced the Bankrupt the sum of $591,264.63 on the security of what it thought were valid accounts receivable. The undisputed evidence, however, is that over $200,000.00 of the accounts receivable were fictitious (App. I, 155-158). Thus, the Bankrupt was inducing the Respondent to loan on non-existent security.

Under standard practice in accounts receivable financing, which was followed by the Respondent in this case, money was loaned against all accounts receivable which appeared at any one time to be eligible, i.e., not over ninety (90) days old. Yet, the Respondent was actually lending more than the valid accounts receivable would justify. Therefore, the Respondent was entitled to look to the factor's lien as collateral, and it was actually advancing new money at the time the designations of lumber inventory were made in June, July and August of 1962. The conclusion of the Court below to this effect was well-founded on the findings of fact of the Trial Court.

It is not the function of this Court to review decisions based upon factual determinations.

> "A court of law, such as this court is, rather than a court for correction of errors in fact finding, cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and

exceptional showing of error." *Graver Tank and Manufacturing Co. v. Linde Air Products Company*, 336 U. S. 271, 275, 93 L. Ed. 672, 677, 69 S. Ct. 535, 538 (1949).

No such showing is made in this case.

B. There is No Conflict of Decisions.

Petitioner asserts that the decision in this case is contrary to the decision of this Court in *McKenzie v. Irving Trust Company*, 323 U. S. 365, 89 L. Ed. 305, 65 S. Ct. 405 (1945). The Court below impliedly affirmed the holding of the District Court that the four (4) designations of lumber inventory made within the four-month period prior to bankruptcy, did not constitute voidable preferences under Sec. 60(a) of the Bankruptcy Act because the designations related back to October 5, 1960, when the notice of factor's lien was filed by the Respondent. The Indiana Factor's Lien Act gave a continuing lien upon the merchandise of the borrower as designated in separate written statements, and upon accounts receivable resulting from the sale or disposition of such designated merchandise. *The Lien was valid from the date of filing the notice and was a continuing lien, even though the merchandise came into existence at a later date.* Indiana Acts 1955, Ch. 167, Sec. 2, Burns' Ind. Stat. (1963 Supp.) Sec. 43-1202, provided:

> "Lien-Written agreement necessary—Continuing lien —Essentials of notice.—If so provided by any written agreement with the borrower, a factor shall have a continuing lien upon such merchandise of the borrower as is from time to time after the execution of said written agreement designated in one (1) or more separate written statements dated and signed by the borrower and delivered to the factor, and upon any accounts receivable or other proceeds resulting from the sale or other disposition of any such merchandise,

without such merchandise being taken into the constructive or actual possession or custody of the factor or of a third person for the account of the factor, and such lien shall secure the factor for all his loans and advances to or for the account of the borrower, together with interest thereon, and also for the commissions, obligations, indebtedness, charges, and expenses properly chargeable against or due from said borrower, and for the amounts due or owing upon any notes or other obligations given to or received by the factor for or upon account of any such loans or advances, interest, commissions, obligations, indebtedness, charges, and expenses. *Such lien shall be valid from the time of filing the notice hereinafter referred to, whether such merchandise shall be in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice or shall come into existence subsequently thereto or shall subsequently thereto be acquired by the borrower.*" (emphasis added).

This Court has clearly held that State law determines when a transfer is perfected for the purposes of Sec. 60(a) of the Bankruptcy Act. In *McKenzie v. Irving Trust Company*, 323 U. S. 365, 89 L. Ed. 305, 65 S. Ct. 405 (1945), this Court said:

"In the absence of any controlling federal statute, a creditor or bona fide purchaser could acquire rights in the property transferred by the debtor, only by virtue of a state law. And hence Sec. 60(a)'s 'apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good faith purchaser.' *Corn Exch. Nat. Bank & T. Co. v. Klauder*, 318 U. S. 434, 436, 437, 87 L. Ed. 884, 886, 887, 63 S. Ct. 679, 114 A.L.R. 1189, 52 Am. Bankr. Rep. (N. S.) 596. See also *Benedict v. Ratner*, 268 U. S. 353, 359, 69 L. Ed. 991, 997, 45 S. Ct. 566, 6 Am. Bankr. Rep. (N. S.) 9, and cases cited. *Section 60(a) in this re-*

spect, as do numerous other federal statutes, see *Davies Warehouse Co. v. Bowles,* 321 U. S. 144, 155, 156, and note 20, 88 L. Ed. 635, 643, 644, 64 S. Ct. 474, and cases cited, *thus adopts state law as the rule of decision. The state standards which control the effectiveness of a transfer likewise determine the precise time when a transfer is deemed to have been made or perfected.*" (Emphasis added).

There is no conflict between the decision of the Court below and the decision of this Court in the *McKenzie* case. The Court below and the District Court both following *McKenzie,* held that the Indiana law relating the factor's lien back to the date of the filing of the notice means exactly what it says, and is just as effective against a Trustee in Bankruptcy as it is against any of the other lien creditors anticipated by the law itself.

The decision of the Court below is squarely in accord with the only other Circuit Court of Appeals decision on this point. The case of *Mattes v. American Acceptance Corporation,* 204 F. Supp. 26 (D.C. M.D. Pa. 1961), *aff'd* 301 F. 2d 908 (3rd Cir. 1962) also applies the ruling of *McKenzie v. Irving Trust Company* to an alleged preference arising under a factor's lien agreement. There, the District Court had said in 204 F. Supp. at 26-27:

> "Under applicable state law, which determines when a transfer is perfected for purposes of Sec. 60 sub. a of the Bankruptcy Act, see *McKenzie v. Irving Trust Co.,* 1945, 323 U. S. 365, 369-370, 65 S. Ct. 405, 89 L. Ed. 305, defendant acquired a continuing general lien effective against subsequent lien creditors from the time of recording, on all merchandise described in the lien agreement and in separate written statements, and on the proceeds resulting from the sale of such merchandise, i.e., the accounts receivable, whether in existence at the time of execution of the agreement or subsequently acquired by the bankrupt. See Maryland

> Factors Lien Act, June 1, 1945, L. 1945, Chap. 1019, Art. 2, Secs. 21-27, Ann. Code of Maryland, as amended April 27, 1951, L. 1951, Chap. 583; Pennsylvania Factors Lien Act, June 10, 1947, P. L. 529, Secs. 1-10, as amended April 1, 1949, P. L. 391, 6 P. S. Secs. 221-229. *In accordance with Sec. 60 sub. a (2) the transfer and assignments are deemed to have been perfected at the time American's lien became effective against subsequent lien creditors, i.e., upon recording, prior to the four-month period, and are therefore not preferential under Sec. 60 sub. a (1).* See 3 Collier, Bankruptcy (14th Ed. 1956), Par. 60.39, p. 912; Id. Par. 60.48, pp. 966, 967; and see legislative history in re amendment to Sec. 60, Vol. 2, 1950 U. S. Code Congressional Service, p. 1985, et seq." (Emphasis added).

The decision of the District Court was affirmed per curiam by the Third Circuit Court of Appeals in 301 F. 2d 908 (3rd Cir. 1962), as follows:

> "Upon review of the record, we find no error.
> "The judgment of the district court will be affirmed on the well-reasoned opinion of Chief Judge Murphy, 204 F. Supp. 26."

While the facts in the *Mattes* case are not clearly set forth in the reported opinion, the statement of law quoted above is directly in accord with the rulings of the District Court and the Court of Appeals in the instant case. An examination of the Record and Briefs in the *Mattes* case in the United States Court of Appeals for the Third Circuit shows that the issue appealed involved the validity of certain assignments of accounts receivable made within four (4) months prior to bankruptcy. The assignments grew out of a factor's lien agreement which had been perfected two years and ten months prior to bankruptcy. The Court of Appeals affirmed on the language of the District

Court decision, that the assignments were effective against subsequent lien creditors from the time of the original recording of the factor's lien prior to the four-month period, even though the assignments themselves were executed within the four (4) months prior to bankruptcy.

There is no conflict between the decision of the Court below and the decision of the Sixth Circuit Court of Appeals in the case of *In Re Summit Hardware, Inc.* 302 F. 2d 397 (6th Cir. 1962), cert. dismissed sub nom. *Foote v. Schwemler,* 371 U. S. 882, 9 L. Ed. 2d 118, 83 S. Ct. 154 (1962). The facts of the *Summit Hardware* case are completely different from the facts of the present litigation. In the *Summit Hardware* case, *no* designations of inventory to be covered under the factor's lien were ever made by the borrower. The borrower and the factor entered into a factor's lien agreement and a notice of factor's lien was properly recorded. But, they made no further effort to comply with the Ohio Factor's Lien Statute, which is similar to the Indiana Factor's Lien Statute, in its requirement that separate written designations be delivered by the borrower to the factor in order to subject inventory to the factor's lien.

The case now before the Court differs from the *Summit Hardware* case, because the Respondent did receive regular designations of lumber inventory from the Bankrupt and the only question is whether the lien referred to in those designations was effective from the time of filing the notice on October 5, 1960.

C. The Interpretation and Application of the State Law Should not be Reviewed by this Court.

We respectfully submit that the Court below was correct in its holding that the lien on inventory designated

within four (4) months prior to bankruptcy relates back to October 5, 1960, under the Indiana law which governs the situation. The precise issue of state law involved is one which has not been decided by the Indiana Courts. However, both the District Court and the Court of Appeals faced the question and held that the effective date of the lien was the date of the filing of notice and that all designations made after that time did relate back to the date of filing the notice as provided by the Indiana statute.

This Court has consistently held that it will not interfere with the interpretation of local law by local courts. *United States v. Durham Lumber Company,* 363 U. S. 522, 526, 4 L. Ed. 2d 1371, 1374, 80 S. Ct. 1282, 1284-1285 (1960). There this Court said:

> "It is suggested that the courts of North Carolina have never specifically described the nature of the property rights created by the North Carolina statutes involved in this case, and that the Court of Appeals' interpretation of those statutes is probably incorrect. However, where '(t)he precise issue of state law involved . . . is one which has not been decided by the . . . (state) courts,' this Court has said that '(i)n dealing with issues of state law that enter into judgments of federal courts, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable.' *Propper v. Clark,* 337 U. S. 472, 486, 487, 93 L. Ed. 1480, 1492, 1493, 69 S. Ct. 1333. Since the Court of Appeals is much closer to North Carolina law than we are, and since we cannot say that the court's characterization of the taxpayers' property interests under that law is clearly erroneous or unreasonable, the judgment is Affirmed."

The interpretation of Indiana law by the Court below is neither clearly erroneous nor unreasonable.

D. The Question of the Interpretation and Application of the Indiana Factor's Lien Law is now Moot because that Law was Repealed as of July 1, 1964.

Finally, the Petitioner urges the review of this problem because an analogous situation is allegedly presented by the Uniform Commercial Code. This point is raised because the Indiana Factor's Lien Act which was in effect at the time this case arose was repealed by the enactment of the Uniform Commercial Code which took effect in Indiana on July 1st, 1964. Suffice it to say that the problems under the two statutes are not analogous and that if there is a problem in this area raised by the provisions of the Uniform Commercial Code, that problem should be resolved in a case arising under the Code, not this one which arose under the now obsolete Indiana Factor's Lien Act.

This Court should not review an issue now moot because of the pertinent statute's repeal. Cf. *District of Columbia v. Sweeney,* 310 U. S. 631, 84 L. Ed. 1402, 60 S. Ct. 1082 (1940), where certiorari was denied "in view of the fact that the tax is laid under a statute which has now been repealed and the question is therefore not of public importance."

2. The Designations of Wood Mouldings.

The crux of the decision of the Court below regarding the designations of wood mouldings is its conclusion that the designations by way of letters sent by the Bankrupt to the Respondent and identifying the wood mouldings only by a dollar amount were sufficient to subject the mouldings to the Respondent's factor's lien. The Court concluded that under Indiana law the fact that it would have been necessary to use parole evidence to identify the specific property secured by the lien did not affect the validity

of the designations or of the lien. The Petitioner has shown no conflict between this conclusion and any Indiana law.

But, the Petitioner claims that the approval of letter designations of mouldings by dollar amounts is in conflict with the decision of the Sixth Circuit Court of Appeals in the case of *In Re Summit Hardware, Inc.*, 202 F. 2d 396 (6th Cir. 1962), cert. dismissed sub nom. *Foote v. Schwemler*, 371 U. S. 882, 9 L. Ed. 2d 118, 83 S. Ct. 154 (1962). Again we submit that there is no conflict with the *Summit Hardware* case because the facts of that case were entirely different. In that case, *no* designations of any sort were ever made.

Even if a conflict between the decision of the Court below and that of the *Summit Hardware* case could be gleaned, the issue would still not be one for this Court. The problem is one of the interpretation of state law and this Court has held that conflicts among circuits as to questions controlled by state law are not of themselves reasons for granting writs of certiorari. *Ruhlin v. New York Life Insurance Company*, 304 U. S. 202, 206, 82 L. Ed. 1290, 1292-1293, 58 S. Ct. 860, 861 (1937). There this Court said:

> "As to questions controlled by state law, however, conflict among circuits is not of itself a reason for granting a writ of certiorari. The conflict may be merely corollary to a permissible difference of opinion in the state courts. The rules indicate that the court will be persuaded to grant certiorari where a circuit court of appeals 'has decided an important question of local law in a way probably in conflict with applicable local decisions.' No such showing was attempted by the petition. Nor was it contended that the decision below was 'probably untenable' and therefore probably in conflict with the state law as yet unannounced by the highest court of the state.

> "No decision at the present time could reconcile any 'conflict of circuits', or do more than enunciate a tentative rule to guide particular federal courts. Therefore, even assuming that it is adequately presented on the record, we decline to decide the issue of state law."

Once the validity of the dollar amount designations of mouldings is established, the burden of showing that the mouldings inventory sold by the Petitioner was *not* covered by the Respondent's lien was on the Petitioner. The Petitioner maintains that since no designations of mouldings inventory were made after July 31, 1962, it was necessary for the Respondent to prove that it still had a valid factor's lien on the mouldings inventory as it existed at the date of bankruptcy, September 28, 1962. The decision of the Court below that the burden of proof on this point was on the Petitioner is well-founded and not in conflict with any of the decisions of this Court.

The Respondent took possession of all of the merchandise at the Bankrupt's plant which had been previously under the Respondent's factor's lien, on September 27, 1962 (Finding of Fact 34, App. I, p. 264). All of the mouldings inventory which was in the possession of the Respondent prior to the bankruptcy was turned over to the Petitioner for sale by him pursuant to an agreement between the Petitioner and the Respondent (Plaintiff's Exhibit "F" App. III, 1). The Petitioner admits that the agreement expressly provided that the rights of the parties should not be deemed altered and that the execution of the agreement should not be deemed an acknowledgment by the Petitioner of the alleged liens or possession of the Respondent. The Petitioner fails to mention, however, that the agreement also provided:

> "The execution of this agreement by Talcott and the operation pursuant to the terms hereof by Talcott and Douglas Guardian Warehouse Corporation shall in no way be deemed a waiver of any of the alleged security interests or alleged right to possession of the inventories by Talcott . . . "

The Petitioner then argues that had this agreement not been executed, the Respondent would have had to enforce its alleged factor's lien on the mouldings inventory in the Bankruptcy Court, and in such a proceeding it would have been required to identify positively the mouldings subject to its factor's lien. *This is not the case.* Had the agreement not been executed, the Respondent would have retained possession of the mouldings inventory which it acquired prior to bankruptcy, and a plenary action would have had to have been brought by the Trustee to question the Respondent's rights to the mouldings inventory. In any such action the Petitioner would have had the burden of proof.

When the Petitioner alleged in his Complaint that:

> "The bankrupt's inventory of mouldings . . . was never subjected to the defendant's factor's lien by proper written designations,"

he had the burden of proof to sustain his allegation. It is a basic rule of evidence that when a negative is averred in a pleading, or Petitioner's case depends upon the establishment of a negative, and the means of proving the facts are equally within the control of each party, the burden of proof is upon the party averring the negative. There is no conflict between the decision of the Court below to this effect and the decisions of this Court. *United States v. Denver & R.G.R. Company,* 191 U. S. 84, 48 L. Ed. 106, 24 S. Ct. 33 (1903).

The Petitioner had within his control all facts and records which would have shown whether additional mouldings were received at the Bankrupt's plant in August and September, 1962. If substantial quantities of additional mouldings had been shipped in, it was Petitioner's burden to present that evidence.

From the facts and the records, it is a reasonable inference that the designation of mouldings inventory on August 6, 1962, as of July 31, 1962, covered inventory that was physically present at the date of bankruptcy and was sold by the Petitioner subject to the Respondent's factor's lien. Defendant's Exhibit 53 shows mouldings inventory as of July 31, 1962 in the sum of $126,297.18. Plaintiff's Exhibit "D", the Receiver's Initial Report to the Court, shows mouldings inventory as of September 28, 1962 in the sum of $83,254.56. The difference of $43,042.62 could readily be accounted for by sales between those dates.

3. **Warehouse Receipts.**

The issue of the validity of the warehouse receipts held by the Respondent is purely a factual question involving the mechanics of the operation of a field warehouse by Douglas Guardian Warehouse Corporation. The Court below reviewed the evidence and the extensive findings of the Trial Court. It then concluded that the evidence supported the Trial Court's finding that:

> "at all times from October 5th, 1960, down to and including September 28th, 1962, Douglas Guardian had custody of and exercised dominion and control over the lumber inventory covered by warehouse receipts." (App. I, 263, Finding of Fact 30).

Therefore, the lien of the Respondent's warehouse receipts is completely valid.

There is no legal issue to be decided by this Court. There are no conflicts with Indiana law. Even a cursory review of the decision of this Court in the case of *Union Trust Company v. Wilson*, 198 U. S. 530, 49 L. Ed. 1154, 25 S. Ct. 766 (1905) shows that the Petitioner's argument that the decision below is in conflict with that case, has no merit.

Even if the field warehouse were improperly operated by Douglas Guardian Warehouse Corporation (and there is no evidence of this), the Respondent had no knowledge or notice thereof. This issue was raised before the Trial Court, and that Court held that even under such circumstances the Respondent's rights to the lumber covered by warehouse receipts would be unimpaired (Trial Court Conclusion of Law 8, App. I, 265). The Court below did not disturb this finding.

Thus, the particular problem of the warehouse receipts raised by Petitioner should not be reviewed by this Court for the additional reason that the warehouse receipts would still be valid because the Respondent knew of no discrepancies. There is no point in reviewing a decision which can be sustained on an alternative ground.

4. **Assignment of Accounts Receivable.**

The Petitioner has alleged that certain assignments of accounts receivable from the Bankrupt to the Respondent were preferential. The Trial Court and the Court of Appeals below held that these assignments grew automatically out of the sale of merchandise covered by the factor's lien of the Defendant. Under Indiana law, the factor's lien then followed the accounts receivable.

The only issue here is whether the assigned accounts receivable did grow out of merchandise covered by the Respondent's factor's lien. Both Courts below found that the

assigned accounts receivable did grow out of the sale of merchandise under the factor's lien. This issue is not one for review by this Court. *United States v. Johnston,* 268 U. S. 220, 227, 69 L. Ed. 925, 926, 45 S. Ct. 496, 497 (1924). There this Court said:

> "We do not grant a certiorari to review evidence and discuss specific facts."

5. **The Chattel Mortgage.**

The net proceeds of all the items covered under Respondent's chattel mortgage amount to $2,488.35. The Petitioner questions the validity of the lien on only a few items having relatively little value. This is strictly a question of the applicability of local law to an isolated set of facts. The decision of the Court below does not conflict with the Indiana Chattel Mortgage Act of 1935, which has now been replaced by the Uniform Commercial Code. Under no circumstances does this decision warrant review by this Court.

Conclusion

For all of the foregoing reasons, it is respectfully submitted that this Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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